SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1789

MR. STEAK, INC. and THE CENTRAL BANK AND TRUST COMPANY,

Petitioners,

vs.

EDINA STATE BANK,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTION PRESENTED

It is believed that a more accurate and correct statement of the question presented is as follows:

> Is there a conflict between Section 5 of the Securities Act of 1933, as amended [15 U.S.C. Sec. 77e] and Article 8-204 of the Uniform Commercial Code, and, if so, does said Sec. 5, as applied to the facts of this case, free petitioners from liability under said Article 8-204?

STATEMENT OF THE CASE

The essential facts of this case are without dispute. Unregistered shares were issued by Mr. Steak to one Price who pledged these shares for a loan made to him by Edina, ultimately amounting to $37,000. Upon default by Price, Edina sold 1000 of said shares. Petitioners refused transfer to the purchaser and the sale proceeds were refunded by Edina.

There was no legend or any statement of restriction on the share certificate. Edina had no actual knowledge of a restriction, if any, and was an innocent party as found by the trial court.

ARGUMENT

The Securities Act of 1933, which is administered by the Securities and Exchange Commission having rule making authority, Sec. 19 [15 U.S.C. Sec. 77s] is silent about the notation on a security of a restriction on transfer. Article 8-204 of the UCC, on the other hand, specifically requires such notation and in its absence, renders any restriction ineffective except against a person with actual knowledge. However, the policy which has obtained under the Securities Act, as expressed through releases of the Securities and Exchange Commission [Nos. 33-5121, 17 C.F.R. Secs. 231.5121 and 33-5223, 17 C.F.R. Sec. 231.5226] with respect to the notation on unregistered shares exempt under Section 4(2) of the Securities Act [15 U.S.C. Sec. 77d(2)], is in effect the same as that expressed in the Uniform Commercial Code requirement. There is, therefore, not conflict but harmony between the two legislative enactments. Moreover, on page 10 of their petition, Petitioners specifically state that they do not contend that any such conflict exists.

Petitioners persistently express the concern that compliance with the State Act would cause them to violate the Federal Act and that all issuers and their transfer agents would be in the same predicament. They also urge upon this Court that the question is unique and that the decision of the Court of Appeals will impede "the free flow of securities in the equity markets".

The Petitioners' concern could easily have been eliminated had Mr. Steak taken the initial simple step of noting the share certificate at the time of issue in conformity with the Federal policy expressed in the Securities and Exchange Commission releases and in compliance with the provisions of the Uniform Commercial Code. (Here Mr. Steak had two opportunities—at the time of the original issue of 200 shares to Price and later upon the issue of an additional 2,400 shares pursuant to a 12 to 1 split.) The exemption from registration would have been preserved by the justified refusal to permit an unregistered or unexempted subsequent transfer. Instead, they seem to argue that since they did not protect themselves, any member of the public to whom a legend free "restricted" security is sold or transferred must protect them. There is nothing unique about a question which simply involves the imposition of liability upon a party who has violated a law or who has not taken reasonable steps to protect himself. And there is no equity or justification for shifting the burden of responsibility from a delinquent party, however large or small, to an innocent member of the public.

Fear of sanctions under the Securities Act is more often not bona fide or more fancied than real. Significantly, the instances appear rare when a transfer agent is held liable for registering a transfer. The great preponderance of cases

involve imposition of liability for *refusal* to transfer. For the most part, unlegended securities are usually registered, or if issued in a bona fide private offering have been held for a sufficient period of time to establish investment intent, or if held by control persons, the transfer agent and certainly the issuer are aware of this fact.

The principal responsibility for compliance with state and federal laws is upon the issuer. Since April 15, 1972, this responsibility and the burden and manner of discharging it is made explicit by Rule 144 under the Securities Act of 1933. The issuer must take the necessary steps. If it fails, the transfer agent must disregard its directions to refuse transfer or comply with them and seek reimbursement for any damage suffered. The transfer agent can easily protect itself as to control persons' shares and shares issued prior to registration, as well as to shares issued under exemptions after registration, by requiring initially complete disclosure by the issuer and obtaining an indemnity commitment from it or refuse to act. The real problem is between the issuer and its transfer agent. An innocent member of the public should not suffer because of their delinquencies.

This is the kind of restriction contemplated by the Uniform Commercial Code. It is not statutory. Under Section 4(2) of the Federal Act, an issuer is permitted to issue shares in a bona fide private offering without registration for investment purposes only. Such shares may not be sold without registration until the investment intent is established. (Now to be held for two years under Rule 144 providing other conditions are met.) The issuer, in its own self interest, has the obligation of noting this restriction on the security to protect its claim of exemption by assuring that a purchaser will not distribute before the invest-

ment intent is established. Of course it is also in jeopardy with or without a legend if the issue did not qualify for the exemption in the first instance. In any event, this is not the making of the transfer agent and its compliance with the Uniform Commercial Code discharges its obligations.

It is difficult to conceive a decision more conducive to the free flow of securities than that of the Circuit Court of Appeals which is here criticized by Petitioners. Instead of impeding the flow, it promotes it. As a result of that decision transfer agents can now determine almost routinely whether or not to make a requested transfer. If there is no statement of restriction, they may comply with the request with impunity unless they have otherwise acquired information that the requestor has actual knowledge of a valid unnoted restriction. It is now clear whereas confusion existed before. Achievement of the orderly administration of the security transfer process is now more assured by the decision below.

CONCLUSION

The writ should be denied and the decision of the United States Circuit Court of Appeals should be permitted to stand.

Respectfully submitted,

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